

# **Kentucky Agricultural Finance Corporation**

## **Meeting Minutes**

**March 12, 2004**

**The Kentucky Agricultural Finance Corporation met at 9:30am on March 12, 2004 in the Kentucky Department of Agriculture Conference Room, 188 Capitol Annex in Frankfort, Kentucky.**

### **Members Present:**

Ms. Sandy Ross; Ms. Annette Crawford Walters; Mr. Bob D. Proffitt; Mr. Patrick Jennings, designee for Commissioner Richie Farmer; Mr. Doug Lawson; Secretary Robbie Rudolph; Mr. Charles Miller

### **Members Absent:**

Mr. Billy Joe Miles; Mr. Wayne Hunt; Dr. Harold Benson

### **Governor's Office of Agricultural Policy Staff Present:**

Mr. David Bratcher; Mr. Bill McCloskey; Ms. Edith Fultz; Mr. Keith Rogers; Mr. Joel Neaveill; Ms. Marjorie May

### **Guests:**

Ms. Kathi Marshall; Mr. Lowell Atchley; Mr. Michael Judge; Mr. Biff Baker

Ms. Annette Crawford Walters – called the meeting to order, announced that the press was notified of this meeting and asked the secretary to call the roll.

Mr. Patrick Jennings – Introduced Michael Judge as the new Director of Marketing and Agribusiness Recruitment in the Kentucky Department of Agriculture (KDA).

Mr. Michael Judge – Told us that he comes from Eastern Kentucky University where he held various positions in their Agriculture Department for the last 23 years, most recently as Chair of the Department.

He talked about the Agribusiness Recruitment initiative KDA is working on. He mentioned a couple of other projects they are currently working on, one having to do with exporting hays to feed camels, the other, a beef cow slaughterer facility.

Ms. Walters – Asked the guest to introduce themselves. The guests gave introductions.

Ms. Walters – entertained a motion for approval of the minutes of the January 23, 2004 meeting. Mr. Charles Miller made the motion; Mr. Billy Hurd seconded the motion; the minutes were approved.

### **Old Business:**

Mr. David Bratcher – Offered a handout on Senate Bill 146 and told us that it has cleared the Senate and is in the House in Committee.

Mr. Keith Rogers – Stated that this bill posted in Committee on March 9<sup>th</sup>. He explained that we expected it to go to the House Committee yesterday, but it was pulled from the agenda because Representative Mike Denham offered an amendment to it. The amendment would allow the Area Development Districts (ADD) to be eligible lending institutions, specifically in the Linked Deposit Program. He explained that we are looking at this to determine how this will affect the bill. There was group discussion and questions as to the reasoning behind this amendment.

Mr. Biff Baker – Told the group that the ADD wants to be a part of this. Mr. Rogers concurred and said there has been limited activity on Linked Deposit across the state.

Mr. Bratcher – Explained that the Linked Deposit Program funds are those funds that remain in the State Treasurer's account from abandoned property and that Kentucky's Affordable Prepaid Tuition (KAPT) program gets first dibs on that surplus property. To the extent that there are funds left over they are invested by the State Investment Commission. The question he expects to come up is whether the State Investment Commission is comfortable making an investment in an ADD. Right now they buy a Certificate of Deposit (CD) from a bank and the bank makes the loan. If the loan goes into default the bank still has to pay the CD back to the state. The key to Linked Deposit is making sure the state doesn't jeopardize its investment. He commented further.

Mr. Rogers – stated that we are at day 47 of this session and the Governor rolled out his Tax Modernization Plan yesterday afternoon. He also noted that next week is when the Senate Agriculture & Natural Resources (ANR) Committee is to complete their part of the budget. He offered to answer any questions the Board may have.

Mr. Bratcher - Offered a handout on the Young Farmer Program and explained where we are at this point. He shared that we have had some discussion with bankers and some discussion of possible financing of farms for young farmers. He voiced staff concerns of whether we have a competitive enough product in the market. He explained that we are approved by Farm Service Agency (FSA) to be a guaranteed lender. We can get our loans guaranteed up to 95%. He pointed out the rates from Farmer Mac, which is the secondary market we can participate in. He explained the way we would envision the Young Farmer Program working; we would first go to FSA, get their approval of the guarantee then come back to the board for approval. We would probably try to lock the rate the day prior to or the day of the board meeting to

allow lea time to talk about an actual rate so the board would be approving a fixed rate of interest for a particular term of loan. He emphasized to keep in mind these loans are 40% of a project, the debt will be subordinate to that of the bank. This will allow the borrower to finance up to 100% of the program. He pointed out some FSA rules and reminded the group that we have a \$250,000 maximum by our statute. The question is what is the benefit of this program to the lead bank? He pointed out that they can get a 95% guarantee not 90%. They can do a 60% loan to value at their rate and ours would be under them so in liquidation they would be more likely to get their entire loan back than if they had a 90% guarantee. We have 5% of our money at risk. He pointed out the interest rates for comparative purposes on the last page of the handout.

He also raised the question of how we, as a state agency, deal with the secondary market. He stated that we are selling essentially state property. Normally we would need to put this out to the competitive bid process. He explained that he anticipates a one shot for one year bid price, where we would have a group of secondary lenders who would agree to work with us. This way we would have a preferred vender list to work with. He suggested that we would have to go through some kind of procurement process. Secretary Rudolph concurred and stated that we would have to develop a RFP for this.

Mr. Hurd asked if this would be the case if a bank was the lead on a loan. Mr. Bratcher responded that he would see a difference if we were participating in a bank's loan. He offered examples. There was further discussion and comments by the group.

Ms. Jones asked if the listed rates are what we have to offer. Mr. Bratcher said these would be the rates as of yesterday. If we were doing a 15 year fixed rate to the borrower the rate would be 5.53% plus whatever we want to add for services. The second question is do we want to add another 50 basis points for services, so the real rate for the borrower would be 6. 3%. Ms. Jones explained that their 15 year rate is 6.2% which is what they call tier 1 financing, they add 40 basis points which will automatically make it be a tier 3 for a guarantee. The true rate for a guaranteed loan is 6.2%. She explained that the highest quality farmers that get these rates. There was discussion by the group with a consensus that the rates we can offer are competitive.

Mr. Lawson commented that there are going to be some banks that are well versed in FSA lending and won't need our services. What we are going to be looking for is the niche market of the other 90% of banks that don't participate on a regular basis. There are a very small number of banks that are already participating. There was further discussion by the group.

Mr. Bratcher pointed out that the board previously approve a maximum term of 15 years and asked if we need to extend that to go out as far as Farmer MAC can go. FSA will guarantee for 25 years. There were comments from board members with a consensus of keeping the maximum term at 15 years.

Mr. Bratcher referenced the pool of secondary markets and stated that when we do an RFP one of the things we can do in the RFP, in addition to putting legal notices in the paper is to send out request for qualifications to the various entities to make sure they meet certain criteria, that they are going to buy the paper from us and what their pricing would be. He then asked about other secondary markets we may want to contact. Ms. Ross mentioned a couple of entities and Ms. Walters suggested that we get a list of approved secondary markets. Secretary Rudolph suggested that we develop a master agreement with the approved list. He suggested that we work with Mike Burnside and Tom Howard to develop this. Mr. Lawson suggested that Mr. Bratcher contact the American Bankers Association (ABA) to get a list of vendors. There were further comments and discussion.

Mr. Bratcher mentioned that FSA has waived the 1% fee, but he feels that we should still charge the 1% origination fee to cover some of our up front costs. There were group comments and discussion. Mr. Lawson suggested we could lower this to .5%.

Mr. Bratcher suggested we go ahead and put this RFP together and then bring it to the board for action.

Mr. Lawson asked if we would be better served to charge a flat rate for packaging with no origination fee. Mr. Bratcher expressed uncertainty as to whether we have enough staff to put these packages together.

Mr. Rogers told us the staffing situation is going to be determined by the budget. In the Governor's Budget we were allowed 17 plus one contractor designated to work with KAFC. He explained that he envisions operating KAFC with Policy Analyst from the ADB with one person managing, coordinating and marketing the product.

Mr. Bratcher added that the \$17 million stayed intact as a bond issue in the House version of the budget.

Ms. Ross asked when are we going public with the program and asked what kind of response we have had to this point. Mr. Bratcher explained that land prices in some areas of the state may not work with this program. He also stated that we would like to process one application before we do broad promotion. Secretary Rudolph asked how we do our press releases. Mr. Rogers responded that we have a Communications Director within GOAP that does all of the ADB press releases. We can utilize that person. He explained that part of the reason for SB 146 is to get the ADB and KAFC side-by-side to use the same resources and send the same message. He also expressed the need to have one person marketing this program for the first twelve months. There were further comments and discussion.

### **New Business:**

Mr. Bratcher brought two applications that have been submitted. He explained that we don't have a formal application form for KAFC, what we have are application forms that

have been submitted to the GOAP for Agricultural Development funds. He added that we are not bringing these to the board for action, but for discussion to get a sense of what the board wants to see which will help us to determine the direction the board would like to go in terms of how to review applications.

Mr. Bill McCloskey presented an application for equipment to produce biodiesel for discussion "Union County Biodiesel Company LLC" (handout provided). He pointed out, on the budget sheet (attached to handout) they listed KAFC request for loan for \$1,054,175, which is the same amount they requested from ADF. He explained that staff has reviewed the application and developed a list of issues. This project will be presented to ADB next Friday. Based on input from KAFC and ADB we will be drafting a letter to the applicant with a comprehensive list of all the issues we have with the application. He read over and explained the issues of GOAP staff. He told the board that we will be asking, what kind of analysis KAFC would want staff to bring on these applications. Mr. Bratcher pointed out that this is a \$2.1 million investment.

Mr. Bratcher offered additional comments on policy questions, one being how much of this program does the board want to see going to tobacco dependent areas.

Mr. Lawson commented stating that this company is probably not large enough in scope, a county only project and he has concerns about the amount of dollars requested. Ms. Walters questioned the experience of the partners and who they are. Mr. McCloskey explained that in the application they identified some people who are interested, they don't have anyone experienced in biodiesel production and they haven't identified anyone to do that. Mr. Bratcher commented that in our opinion this is a project that is an ideal candidate for B&I loan guarantee from USDA. If we were to participate at all it would be with that lender on part of their guarantee. He stated that although he cannot speak for the ADB, it is probably too much request for ADF relative to the project and the impact on net farm income statewide. Patrick Jennings commented that we need to see where the whole biodiesel thing plays out. Mr. Bratcher pointed out the study attached to the application and explained that this is not a typical application that the ADB sees. He explained further and asked how much detail the KAFC wants. He also asked what kind of appraisals do they want and do they want FSA certified appraisers. He pointed out that, costs to the borrower comes with all of this. There were comments from the group. Mr. Jennings suggested that we wait and see what the Legislature is going to do with biodiesel. There were additional comments from board members. Mr. Bratcher asked what kind of presentation the board would like to see. Ms. Walters stated that there needs to be more financial information and explanation on how they plan to pay back. Mr. Lawson stated that they need a more qualified approach to their pro-forma work. He suggested they need to hire a CPA, get projections and studies done. Mr. Bratcher asked if the bankers, within their institutions, have their own credit analysis people. Mr. Hurd responded that they have a full department for loan analysis and explained further. There was group discussion. Secretary Rudolph suggested that the bankers on the board get together and figure out what is needed. There was further group discussion. Mr. Hurd suggested that four or five criteria would give the board enough information to make a

decision. Mr. Lawson concurred and suggested that there are fourteen key ratios you can take and tell all you need to know about a business. Mr. Hurd suggested that we need to look at something other than collateral based lending. Mr. Miller commented that it is time in the process for applicants to understand up front that they need to satisfy some very structured financial criteria. He suggested that this applicant doesn't appear to understand that requirement. In regard to this particular project, in looking at the scope of what we are trying to do, he suggested he would prefer to see a biodiesel producer brought in that is going to help all the soybean producers in West and South Central Kentucky. Mr. Bratcher commented that statute would not allow us to make a direct loan of this magnitude. If HB 146 does pass the board may want to consider how much direct lending we want to do. He explained further.

Mr. Bratcher presented an application "Lake Cumberland Milling LLC" (handout provided). He offered history on this project; explaining that in 2001 the ADB approved a grant for Cumberland Valley Milling, which was a group of producers who had formed a cooperative and planned to purchase Wayne County Feed and build a feed mill. He explained that they were anticipating receiving a \$2 million grant from USDA to fund the building for the feed mill. The money never was forthcoming from USDA, so the cooperative abandoned the project. There is a group of farmers in the area that would like to move forward with this as a soybean extrusion facility. He explained that there are 27 producers now who have bought stock in this LLC with a \$200,000 investment. The money is escrowed in the Monticello Banking Company (Billy Hurd's Bank). They are proposing a grant and a forgivable loan from the ADB as well as a loan from the KAFC. He summarized the benefits and concerns of the ADB. Mr. Hurd offered comments on the amount of work involved in this project, the benefits it could bring to the area and that Monticello Banking Company is supporting this project. He offered to entertain any questions or concerns from the board. Mr. Bratcher questioned if the bank would have any difficulty allowing KAFC participation in the loan. Mr. Hurd responded, explaining that their senior executive officer had asked him to explore any avenue he could with KAFC to help these local farmers. Mr. Bratcher mentioned the comfort level of the board on appraisers. Does KAFC want a FSA approved appraisers? Mr. Hurd commented that this group has asked him what KAFC and the ADB want to see and asked for direction for this project. He said if we can determine what key criteria we want to see as a group to make these decisions, it will help direct them. Ms. Walters responded to the question of if we want a MAI or FSA approved appraiser and suggested we could go with either. There was group discussion. Ms. Walters questioned if there is an appraisal on this project, mentioned the contingency for cost overrun and the need to be cash flow aware. Mr. Bratcher commented that some of the equipment will be coming from Germany and will be sensitive to dollar valuation. Ms. Walters commented that they weren't including the costs of installing this extruder. Mr. Bratcher responded that they have an existing facility. Mr. Hurd stated that this would be retro-fitting. Ms. Walters mentioned existing debt. Mr. Hurd responded that to his knowledge there is none. Ms. Walters questioned the cost of insurance. There was further discussion.

Mr. Bratcher listed three action items.

1. Work with Secretary Rudolf and the Finance Cabinet Staff on putting together a RFP and develop a list of secondary market providers.
2. Staff will come back to the board with appraisal recommendations.
3. Volunteers from the board may help put together some thought on presentation material (we could meet by conference call).

Mr. Lawson agreed to send a few packages for us to review.

Mr. Rogers suggested these volunteers could meet an hour before the board meeting.

There was group discussion.

**Next meeting date:**

May 14<sup>th</sup>, 2004

**Adjourn:**

Ms. Walters called for a motion to adjourn the meeting; Ms. Ross made the motion; Mr. Lawson seconded the motion; the meeting adjourned at 11:37am

APPROVED: \_\_\_\_\_

PRESIDING OFFICER: \_\_\_\_\_

SECRETARY: \_\_\_\_\_